



Employer Services Division
P.O. Box 942709
Sacramento, CA 94229-2709
Telecommunications Device for the Deaf - (916) 326-3240
(916) 326-3240 FAX (916) 326-3005

December 16, 2008

AGENDA ITEM 4

TO: MEMBERS OF THE BENEFITS AND PROGRAM ADMINISTRATION COMMITTEE

I. SUBJECT: Public Hearing and Committee Recommendation:
Proposed Regulations for Determination of
"Employee" Status

II. PROGRAM: Retirement

III. RECOMMENDATION:

Staff recommends that, subject to the results of the public hearing, the Committee recommend that the Board adopt the regulations in the proposed Article 6.5, which make specific the criteria used to determine employee status for purposes of the Public Employees' Retirement Law (PERL).

IV. ANALYSIS:

At the September 17, 2008, board meeting, the Board approved for publication proposed regulations to assist employers and CalPERS staff in determining whether an individual is an employee of a CalPERS employer and therefore is eligible for CalPERS membership.

A Notice of Proposed Regulatory Action was published in the California Regulatory Notice Register (CRNR) 2008, No. 42-Z, October 17, 2008 (see Attachment A). Originally a public hearing was scheduled for December 17, 2008. Thereafter, the public hearing was re-noticed for December 16, 2008 at 8:30 a.m. (see Attachment B).

The written comment period for the proposed regulatory action closed on December 1, 2008. CalPERS received six written comments on the proposed regulations. Two written comment letters were submitted by CalPERS employers, one of which supported the regulations without changes and the other suggested adding additional criteria. Three of the other comment letters were submitted by three separate associations that do not contract with the Board for retirement benefits, each expressing concern about the scope of the regulations. The final written comment was provided by an attorney currently

representing county superintendents of schools in a pending appeal scheduled for hearing early next year. These comments also expressed concern about the scope of the regulations.

Several of the comments from the non-CalPERS employers raised many of the same issues. Comments have been grouped so that similar issues are considered together in the attached Summary of Written Comments and Responses (see Attachment C). Additionally, the actual written comments and staff's response letters are attached (see Attachment D).

The written comments received by CalPERS have been grouped into the 10 questions articulated below.

1. What is the purpose of the proposed regulations?
2. Are the proposed regulations authorized by law? Do they misread or change existing law?
3. From where do the factors included in the proposed regulations come?
4. Will the proposed regulations potentially eliminate CalPERS eligibility for hundreds or thousands of CalPERS members?
5. Should the proposed regulations be expanded to include joint or co-employment?
6. Why do the proposed regulations fail to address statutory employment?
7. Has the Board previously adopted exceptions to the common law test for employment?
8. Should the proposed regulations be changed to address "certain employment relationships"?
9. Should additional factors be added to the proposed regulations?
10. Are the proposed regulations vague and open to arbitrary application?

CalPERS' responses to the aforementioned questions are set forth, in brief, below. Additional detail is included in the attached Summary of Written Comments and Responses and in the individual response letters.

1. The purpose of the proposed regulations is to set forth the factors that are central to the proper determination of employee status and from there, the eligibility for CalPERS membership for retirement benefits. The regulations are necessary because under the Internal Revenue Code, in order to preserve the plan's tax-qualified status, assets of our plan must be held for the "exclusive benefit" of the participating employers' employees and their beneficiaries.

Government Code section 20028 generally defines "employee" for the purposes of the PERL. The proposed regulations require that the term employee be determined using the common law test for employment. The regulations seek to make specific, interpret and apply the PERL, the applicable case law and the

Board's Precedential Decisions which set forth the applicable criteria of the common law test for employment.

2. The regulations are authorized because Government Code section 20125 provides that the Board of Administration shall determine who are employees and is the sole judge of the conditions under which persons may be admitted to and continue to receive benefits under this system. The California Supreme Court in its 2004 *Cargill* decision held that when determining whether individuals are employees of a public agency, CalPERS must apply the common law test for employment. In the Supreme Court's discussion, the factors identified in *Tieberg v. Unemployment Ins. App. Bd.* were referenced.¹ These same factors have been incorporated into two Precedential Decisions issued by the Board.² The proposed regulations do not misread or change existing law. Instead, the regulations apply the law that has been articulated by the California Supreme Court and in Precedential Decisions by the Board.

3. The factors articulated in the proposed regulations come from the decisions in the *Cargill* and *Tieberg* cases and from Board's Precedential Decisions cited above.

4. Staff disagrees with comments asserting that the proposed regulations will potentially eliminate CalPERS eligibility for hundreds or thousands of CalPERS members. No specific examples or concrete data were provided to support this assertion. The proposed regulations will not eliminate CalPERS membership eligibility for CalPERS participating employers' common law employees. If individuals who are not the common law employees of CalPERS employers are reported to CalPERS, they are reported in error. When staff discovers such errors, corrective action is taken on a case-by-case basis. Contracting public agencies and schools have the right to file an administrative appeal if they disagree with staff's decision. If ultimately a determination is made that an individual fails to qualify for CalPERS membership under the common law test for employment, then service credit must be reversed out and member contributions must be refunded.

5. Staff also disagrees with comments suggesting that the proposed regulations be expanded to include joint or co-employment. CalPERS is bound to follow the applicable law discussed above when determining employee status and membership eligibility. This requires an analysis of the common law test for

¹ See *Metropolitan Water District of Southern California v. Superior Court* (2004) 32 Cal.4th 491 (also referred to as the "Cargill" case) and *Tieberg v. Unemployment Ins. App. Bd.* (1970) 2 Cal.3d 943.

² See *In the Matter of the Application for CalPERS Membership Credit by Lee Neidengard v. Tri-Counties Association for the Developmentally Disabled*, Precedential Decision Case No. 05-01 (2005) and *In the Matter of the Application to Contract with CalPERS by Galt Services Authority*, Precedential Decision Case No. 08-01, (2008).

employment. The fact that an individual may be joint or co-employed under a statutory scheme other than the PERL is not relevant to whether that individual providing services to a CalPERS employer qualifies as an employee of that employer under the PERL. The Board has referred to the common law test for employment factors in two Precedential Decisions when examining questions relating to employee status. However, the Board has never issued a Precedential Decision recognizing joint or co-employment as a basis for CalPERS membership eligibility or as an exception to the common law test.

6. No discussion of the “statutory employment,” which CalPERS understands to mean general statutory authority on the part of an employer to hire employees, was included by staff in the proposed regulations because the topic is irrelevant to determining employee status and individual eligibility for purposes of CalPERS membership. CalPERS must utilize the common law test for employment to determine these issues and the fact that an employer may have the general statutory authority to hire employees is not relevant to this determination.

7. The Board has not issued any Precedential Decisions which adopt exceptions to the common law test for employment when determining employee status under the PERL.

8. CalPERS staff disagrees that it should expand the proposed regulations to cover more than the determination of employee status under the common law test for employment. The proposed regulations have a limited purpose --- making specific the criteria for employee determinations under the PERL.

9. Staff disagrees that additional criteria should be added to the proposed regulations because the suggested additional criteria were not included in the common law test for employment articulated in the Supreme Court cases and Precedential Decisions cited above.

10. The proposed regulations are neither vague nor open to subjective and arbitrary application. As detailed above, the factors articulated in the proposed regulations are taken from Supreme Court decisions and Board Precedential Decisions which incorporate the common law test for employment. The cases and decisions provide guidance and illustrate how the test is to be applied. Setting forth the common law test for employment in regulations removes questions as to what criteria should be applied when making employee determinations.

One additional statement included in the comments suggests CalPERS utilize the IRS Employee Plans Compliance Resolution System to correct prior reporting errors. Staff concludes that this suggestion on how CalPERS might correct past erroneous reporting of a person who is not entitled to CalPERS membership is informational, rather than a comment on the proposed regulations.

Staff is not recommending any changes to the proposed regulations as a result of the written comments.

The purpose of the public hearing is to allow the public to present testimony regarding the proposed regulatory action. The Committee is not required to respond to these comments during the hearing; rather, all comments must receive a response from CalPERS as part of the final rulemaking file.

At the conclusion of the public hearing the Committee will decide whether to recommend adoption of the proposed regulations to the full Board. If the Board decides to adopt the proposed regulations, the rulemaking file will be forwarded to the Office of Administrative Law (OAL) for review and approval. Once OAL has approved the proposed regulations, they will be forwarded to the Secretary of State for filing and publication in the California Code of Regulations. The regulations will become effective 30 days after filing with the Secretary of State.

V. STRATEGIC PLAN:

Implementation of these regulations is not a specific product of the Strategic or Annual plans but is part of the regular and ongoing workload of the Employer Services Division.

VI. RESULTS/COSTS:

Implementation of these regulations will help CalPERS comply with Federal tax laws, maintain a consistent practice of enrolling members at the appropriate time, and also ensure that the actuarial liabilities of such membership are accurately computed.

CalPERS may achieve cost savings as a result of decreased litigation and administrative appeals dealing with these issues, as employers and individuals become more aware of the criteria CalPERS uses in making such determinations.

Lori McGartland, Chief
Employer Services Division

Ronald L. Seeling, Chief Actuary
Actuarial and Employer Services

Attachments